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UNITED NATIONS
Economic Commission
for Africa

E/ECA/TRADE/90/2

The Feasibility Study on the Establishment of an African Monetary Fund (an Update)*

LC/NAIROB

* This study was first prepared by the staff of ACMS, ECA, ADB, IDEP and OAU in 1984 and updated in 1989 by the staffs of ACMS, ECA and ADB in consultation with OAU staff. It was again revised early 1990, taking into account the views of the Ad hoc Expert Group which met in November/December 1989.

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TABLE OF CONTENTS

Chapter		Page
I	GENERAL INTRODUCTION: ECONOMIC, MONETARY AND FINANCIAL BACKGROUND	1
	PART I	
II	THE PROPOSED AFRICAN MONETARY FUND	15
III	THE OBJECTIVES, FUNCTIONS AND TECHNICAL OPERATIONS OF THE PROPOSED AFRICAN MONETARY FUND	18
IV	ORGANIZATIONAL STRUCTURE OF THE AFRICA MONETARY FUND	24
V	FINANCIAL RESOURCES OF THE AFRICAN MONETARY FUND	31
VI	BROAD GUIDELINES ON LENDING POLICIES OF THE FUND	56
	PART II: ALTERNATIVES	
VII	TRANSFORMING THE ACMS TO BECOME A NUCLEUS OF AN AFRICAN MONETARY FUND	63

CHAPTER I

GENERAL INTRODUCTION: ECONOMIC, MONETARY AND FINANCIAL BACKGROUND

a. Some Basic Issues of Concern to Africa

1. For the past 25 years or so, growth rates in most developing African countries have steadily declined. Export earnings have gradually decreased while import bills have increased 1/, fiscal and monetary policies have not adequately addressed the problems of generating savings and as a result, capital accumulation has not taken place at a pace commensurate with the countries' immense development needs; there have been significant transfers of profit and capital from Africa; and the lack of a regional monetary institution to co-ordinate the monetary and financial activities of member States vis-a-vis external institutions has also weakened Africa's position. As the ability of the African countries to generate domestic resources has been drastically reduced, they have been rendered increasingly dependent on external borrowing to finance their development programmes.

2. In recent years, the social and economic crisis has forced a number of African countries to embark on stabilization and structural adjustment programmes with

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1/ See also United Nations, Department of Economic Affairs, Commodity Trade and Development, (E/2518), page 16.

the encouragement and support of the two Bretton Woods institutions or on their own initiatives. Thus,, during the period 1980-1988, as many as thirty-three African countries had put in place stabilization programmes under the Stand-by Arrangement Facility of the IMF while fifteen countries had structural adjustment programmes (SAPs) financed by the World Bank and the African Development Bank. The impact of SAPs on the well being of the different sections of African societies has been the subject of considerable research as attested by the proceedings of the international conference on the Human Dimension of Africa's Economic Recovery and Development held in Khartoum in 1988, as well as studies carried out by the IMF, the World Bank, ILO and UNICEF 2/. These studies have acknowledged the seriousness of the impact of stabilization and structural adjustment on the human conditions in Africa. In this respect, the establishment of appropriate institutions may provide African countries with an alternative framework which would enable member countries to adjust more effectively while at the same time minimizing social costs of adjustment and transformation 3/. African institutions and the African Monetary Fund would be more sensitive to the sentiments of African countries in the

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2/ ILO, International Review, Vol. 127, No. 6, 1988.

3/ ECA, African Alternative to Structural Adjustment Programmes (AA-SAP: A Framework for Transformation and Recovery, E/ECA/CM.15/6/Rev.3.

-GORNIA Giovanni Andrea: Adjustment with a Human Face, Oxford Clarendon Press, 1981

-Huang, Yukon & Nicholas, Peter, "The Social cost of Adjustment" in Finance & Development, Washington DC, Vol. 24, No. 2, June 1987.

The Khartoum Declaration, "International Conference on the Human Dimension of Africa's Economic Recovery and Development "Khartoum, Sudan, 5-8 March 1988.

implementation of their programmes than non-African ones. Such institutions could also be expected to be capable of assisting in designing a broad adjustment framework for all African countries irrespective of the differences in their economic systems and approaches to development.

3. The contribution of the monetary and financial sector to economic development and integration in Africa will be enhanced by well thought out regional monetary and financial strategies and policies. This is why the Lagos Plan of Action calls for effective mechanisms to ensure that a sound regional financial and monetary institution could be established to deal with the problems posed by a multiplicity of inconvertible currencies, the lack of effective money and capital markets, mounting external debts and depleted foreign reserves. By strengthening intra-African monetary and fiscal cooperation as well as payments and clearing arrangements, it should be possible to reduce Africa's external financial dependence and vulnerability and increase the capacity of its countries to undertake adjustment with transformation.

4. In particular, the multiplicity of African currencies needs to be addressed as most currencies are not readily acceptable across national frontiers except where parallel markets operate in respect of certain currencies 4/. There is at present no regional framework within which African

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4/ For some discussion of the issue of national currencies in an international context see Robert Triffin, The World Money Maze: National Currencies in International Payments (Yale University Press, 1966).

countries could work to harmonize their currency and exchange control practices and remove monetary obstacles to the expansion of intra-African trade. The creation of monetary institutions which could facilitate the movement towards intra-currency convertibility, monetary integration and improved monetary and financial management, would contribute towards economic and financial development throughout the African continent.

5. In the context of international monetary and financial relations, African countries need to strengthen their capacity to respond to developments such as the establishment of a single European Monetary System following the creation of the European common market in 1992.

b. The Management of African Monetary and Financial Policy

6. The issues identified in the preceding section reflect the tremendous problems experienced by many African countries in managing their domestic monetary and financial situations. Such problems have arisen especially during efforts to deal with chronic balance-of-payments deficits and mounting external debts. Most African countries are not equipped to deal with the sudden changes they are experiencing in their monetary situations. Their reactions can be described as ad hoc, relying on stop-gaps and palliatives amid a scramble for external resources to cope with the problem.

7. These problems stem from domestic policies which do not encourage savings and investment. For instance, nominal interest rates have long been too low, ranging from 5 and 10 per cent, while inflation, mainly arising from monetary expansion, has stood at 20 per cent or more. One of the results has been negative real interest rates which in turn have not encouraged the flow of savings to the banks or other financial institutions. This has deprived the financial system of a major source of domestic investment funds. Low nominal interest rates have also discouraged commercial banks and other financial institutions from providing funds for either productive investment or working capital, because the high risks involved could not be covered with prevailing rates. In short, most African countries are suffering from deep "financial repression".

8. The situation in Africa is that Central banks' use of monetary policy instruments, such as changes in required reserves, interest rates or open market operations, does not always bring about the desired changes in the quantity of money or other credit conditions because of the shuffling of portfolios by asset holders, especially by the transnational banks 5/. In developing Africa, therefore,

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5/ For issues on transnational corporations, see UNCTC, Transnational Corporations in World Development: A Re-Examination (E/C.10/38) March 1978 and ECA, Transnational Corporations in Africa: Some Major Issues (E/ECA/UNCTC 21), See also Transnational Corporations in World Development, Trends and Prospects, ST/CTC/89, New York, 1988.

even the wherewithal for an active monetary policy does not exist. Economies are not wholly monetized; there is a large subsistence sector on which interest rates exert little influence, and organized capital and money markets that do exist are not integrated with the rest of the economy. These features severely restrict the efficacy of monetary policy in developing Africa.

c. The impact of external factors on money and finance in Africa

9. Available data on resource flows confirm that capital inflows have stagnated in real terms. As shown in Table 1, these flows amounted to £20.5 billion in 1987, 17.1 per cent more than in 1986. In real terms (in 1986 prices), the rise was only 2.3 per cent from 1980 and to 1985, followed by a fall of 2.2 per cent in 1987. An examination of the structure of resource flows shows that export credits fell drastically to a negligible level from $1.9 billion in 1980, and that private flows in 1987 were lower than they were in 1980, by 17.9 per cent. It is mainly official development finance which has increased, to represent 88.8 per cent of total flows in 1987, compared with 80 per cent in 1980. Such a development, though it means that resources are obtained on less onerous terms by Sub-Saharan African countries, implies that significant investment resources are no longer forthcoming, since a major share of official flows are not directly used for investment, while the reverse is true for private flows.

Table 1

Net Resource Flows to Sub-Saharan Africa
1980, 1985-1987
(Billions of Dollars)

	1980	1985	1986	1987
Official Development Finance (ODF)	10.4	11.9	14.9	18.2
Offical development assistance	8.7	10.6	12.9	14.6
Bilateral	6.2	7.3	8.9	...
Multilateral	2.5	3.3	4.0	
Other ODF	1.7	1.3	2.0	3.6
Export credits	1.9	0.8	0.4	0.0
Private flows	2.8	2.2	2.2	2.3
Total flows	15.1	14.9	17.5	20.5
Memorandum item:				
Total flows at 1986 prices and exchange rates	17.3	18.3	17.5	17.9

Source: OECD, Financing and External Debt of Developing Countries, 1987 Survey, (Paris, 1988).

10. Recent figures from the 1988 OECD report on development cooperation 6/ (which are lower than those quoted in table 3 from an earlier publication) show that total net ODA flows to African countries, including North African ones, which had reached $16 billion, had fallen to $13.8 billion in 1987 (at 1986 prices and exchange rates). This fact is a further indication of the contraction of resource flows to African countries.

d. Afica's External Indebtedness and Resources Management 7/

11. Africa's external debt position worsened in 1988 and is projected to become even more critical in 1989 and beyond (see Table 2). The stock of external debt outstanding has risen sharply since 1980, to reach about $230 billion in 1988. This figure amounts to 81.1 per cent of total regional GDP and accounts for about 314.2 per cent of exports of goods and Services. Indeed, for some countries, such as the Gambia, Guinea Bissau, Mozambique, Somalia and Sudan, the latter ratio currently exceeds 1000 per cent. In the three years between 1985 and 1988, the debt stock increased by about $55.6 billion,

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6/ Development Co-operation, 1988 Report, DAC, OECD, Paris 1988.

7/: ECA, African Debt Problem: measurement, management and development implications E/ECA/PSD.5/3.

ECA, Alternative systems of external resources management including management of the external debt, E/ECA/TRADE/88/18.

ECA, Economic Report on Africa, 1989, op. cit.

See also OAU, African Common Position on Africa's External Debt

In the same context, one would like to consult APPER and UN-PAAERD.

amounting to a full year's earnings from exports.

12. Despite repeated rescheduling and increasing difficulties in obtaining new loans, the volume of debt increased by about $10 billion in 1988 alone. This increase essentially reflects valuation effects associated with the continuing decline in the external value of the US dollar, the accumulation of arrears and the capitalization of interest payments due, as new lending increased only marginally. The continuing rise in the volume of debt and the debt ratio underscores the excessive burden imposed on African economies and their vulnerability to adverse external developments. The proper understanding of the African debt crisis, therefore, requires that it be placed within the framework of the concomitant adverse developments in commodity prices and resource flows and the on-going efforts of adjustment.

Table 2
Developing Africa:External Debt and Debt service
1985 - 1988

	1985	1986	1987	1988*
	Billions of Dollars			
Total Debt	174.4	190.0	220.3	230.0
Debt Service	24.3	26.4	26.1	29.3
Debt Burden	(in percentages)			
Debt/GDP	52.6	62.2	71.0	81.1
Debt/Exports	205.2	289.6	308.5	314.2
Debt Service/Export	28.6	40.2	36.8	40.0

Source: OECD, Financing and External Debt of Developing Countries, 1986 Survey (Paris, 1987)

OECD, External Debt Statistics (Paris, 1988);
IMF; World Economic Outlook (October, 1988);
World Bank World Debt Tables, 1988-1989 Edition;
African Economic Deficit, Issues; and
ECA Secretariat

*Preliminary estimates

e. Balance-of-Payments Problems

13. The previous sections indicated that developments in the monetary and financial sector inside and outside Africa were largely responsible for the balance-of-payments problems and extenral indebtedness of African countries individually and collectively. Table 3 shows the balance of merchandise trade and balance-of-payments of African countries between 1985 and 1988. A matter of real concern to the African countries is that while the deficits in their balance of payments not only persist but increase.

Table 3

Balance of Payments of Developing Africa

(Billions of US dollars)

	1985	1986	1987	1988
Exports f.o.b	64.0	49.8	57.3	66.8
Imports f.o.b	58.1	52.2	53.9	62.7
Trade balance	5.9	-2.4	3.4	4.1
Services and private transfers (net)	-13.0	-11.3	-14.6	-17.2
Current account balance	-7.1	-13.7	-11.2	-13.1

Source: ECA, Surveys of Economic and Social conditions in Africa, 1985-1986, 1986-1987 New York, 1988.

14. The usual approach to the problem as offered by the International Monetary Fund, calls for stabilization. Yet there are, however, strong views in some African quarters, supported by independent empirical studies, that the problem is a structural one. For instance, it is argued that in the context of a predominantly primary commodity export economy, export product diversification should result in improved export performance and increased earnings. Thus, the problem of balance of payments deficits in Africa calls for measures to restructure and diversify the economies, not merely stabilization.

f. African Monetary and Financial Integration

15. During the past two decades or so, considerable progress has been made in establishing monetary, financial and development institutions to deal with Africa's socio-economic problems. In the area of development finance, at the regional level is the African Development Bank and at sub-regions are the Development Bank for West African States, the East African Development Bank, the Trade and Development Bank for Eastern and Southern African States, the ECOWAS Fund, and the Arab Bank for Economic Development in Africa (BADEA). There are also important monetary institutions such as the African Centre for Monetary Studies and the Association of African Central Banks, and sub-regional payments and clearing arrangements such as the West African Clearing House, the Central African Clearing House and the Clearing House of the Preferential Trade Area of Eastern and Southern African States.

16. Despite these positive developments, the African countries remain heavily dependent on external institutions

in the monetary and financial fields. Africa's banking and credit systems evolved during the colonial period, and post-independence monetary and financial institutions have largely followed the patterns of the pre-independence era 8/. In the former British colonies, currencies were issued by Currency Boards and as such Britain controlled the monetary and financial policies of its possessions. The arrangements in the Franc zone had similar purposes and objectives. These arrangements have not in themselves resulted, however, in the establishment of a regional monetary system through monetary and financial integration.

17. The role of indigenous banking and financial institutions is increasingly being recognized as vital to the efforts towards economic recovery and development in Africa. By fostering financial integration accompanied by significant structural changes in financial markets, efficiency will be improved by reduction in intermediation costs, an increase in the ability to hedge against financial risks associated with currencies, interest rates and price volatility.

18. In view of the significance of these basic issues of concern to Africa, in the monetary and financial fields, and with a view to facilitating African economic monetary integration, the OAU Heads of State and Government decided

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8/ See also, Tamas Szentes. The political economy of underdevelopment, Budapest, pp. 177 and seq.

that an African Monetary Fund should be established. At the same time, they directed that:

> "... Steps must be taken to ensure that new multinational institutions are established only after careful considerations of their necessity, objectives and activities and where there is clear indication that they will obtain the political as well as the financial support of member States." (L.P.A., paragraph 264) and that
>
> "... No new multinational institutions should be created unless their creation has been thoroughly examined and after the possibilities offered by national institutions and existing multinational ones have first been fully considered. "(L.P.A., paragraph 264 iii).

19. In recognition of the seriousness of the above directives, the following chapters of this study examine various alternative options for addressing the basic issues of concern to Africa as highlighted in the preceding section, and for promoting African monetary and financial cooperation, within the context of African economic integration and development. These alternative options are: an African monetary fund; an African payments union, and an arrangement by which one of the national or sub-regional central banks could serve as a nucleus of regional monetary arrangement, with the ACMS performing the economic policy/analysis functions.

PART I:

CHAPTER II

THE PROPOSED AFRICAN MONETARY FUND

a. Introduction

20. When the Heads of State and Government decided that, among others, an African Monetary Fund should be established, they believed that such an institution could play a significant role in addressing monetary problems in the continent in the same way as the African Development Bank is filling a gap in the area of mobilization of development finance. This part of the study will, therefore, be devoted to the examination of this issue. In the first section, the rationale or need for the Fund will be stated, followed by its objectives, functions and organizational structure in section 2, financial viability in the third section and the operational guidelines in the last section.

b. The rationale for the Establishment of an African Monetary Fund

21. The basic rationale for the establishment of an African Monetary Fund can be summed up in terms of its expected impact in filling gaps in Africa's socio-economic development process through its monetary and financial operations. Further for both political and economic reasons, the establishment of an African Monetary Fund would be of fundamental and historical significance in the attainment of collective self-reliance.

22. More specifically, the Fund could play a role which the national or sub-regional monetary institutions cannot. These include: (a) resolution of African monetary and financial problems in an African contest; 9/ (b) the possibility of moving towards a common unit of account, especially for reducing intra-African transactions costs; (c) availability of new sources of credit and capital; (d) the opportunity to introduce a framework for African monetary and exchange rate policy and African-oriented adjustment programmes; (e) provision of technical support to national and sub-regional monetary institutions; (f) an opportunity for African people to build the capacity for economic management and monetary policy analysis at the regional, as opposed to national, level; and (g) above all, the opportunity for African countries to move towards the goal of pooling international reserves, thus realizing savings, and ultimately towards a single monetary zone with a single currency. Thus, an African Monetary Fund need not duplicate or even compete with existing subregional, regional or international monetary and financial institutions in objectives, policies or operations.

23. It is difficult to see how Africa will make progress in the years to come if it chooses a path of economic isolation. There is no need to establish that Africa is facing a technological gap in relative terms and that Africa's production and investment are progressing at a much slower pace than required. For these reasons, Africa's trade relations with the rest of the world will have to be developed but not as disadvantageously as witnessed in the past.

9/The need for an institution of this type has also been felt in other developing regions of the world and this has resulted in creation of the Arab Monetary Fund, the Andean Reserve Fund currently being transformed into the Latino American Reserve Fund, the ASEAN Swap Agreement, the Central American Monetary Stabilization Fund, and the Latin American Free Trade Association's Financial Assistance Agreement.

The proposed Fund will thus help to overcome distortions in prices, exchange rates and such other obstacles which hamper the development of Africa's trade both internally and internationally. It will need to be equipped, therefore, with the necessary expertise to promote these objectives. The Fund will give priority to the development of regional trade.

24. The focus of attention of policies of the Fund may vary over time as developments take place both in Africa and the rest of the world. For this reason, the institution proposed to be set up should be empowered to cope with the newer issues in the monetary field. Now, the Fund will be expected to evolve upwards from the original tasks it assigned itself. This will also guarantee that it will have a lasting character over time when it will have to consider Africa's joint response to issues being raised in the monetary area on the world plane.

25. Broadly speaking, the basic objective of the Fund will be to improve monetary confidence in the African region and to avoid tensions due to volatile prices, interest rates and exchange rates although its fundamental role will be to promote the economic integration of the African continent.

CHAPTER III

THE OBJECTIVES, FUNCTIONS AND TECHNICAL OPERATIONS OF THE PROPOSED AFRICAN MONETARY FUND

26. The Fund will aim to promote economic integration among African countries. Thus its facilities will ensure at each step that some degree of harmonization among African countries is achieved. For instance, it may promote exchange on a basis which is likely to reassure the parties to the exchange that payment will effectively be made and that financial policies pursued by the parties in question will strengthen, rather than impair future exchanges. In other words, it will provide financing primarily in such actions as will bring about the expected cohesive response of African economies to international developments. African countries cannot afford to undertake economic policy actions which are at cross-purposes with each other. The proposed Fund will therefore ensure that it will generate the necessary monetary responses from member countries so as to promote a more integrated functioning of African economies.

a. Objectives of the African Monetary Fund

27. It is, therefore, recommended that the African Monetary Fund should have the following broad objectives

(i) To promote monetary, exchange and financial co-operation among member States with a view to facilitating the achievement of economic integration and social and economic development.

(ii) To provide support for financing balance of payments of member States especially with a view to assisting intra-African trade.

(iii) To provide a forum for consultation, coordination and collective action on regional and global monetary and financial issues.

b. Functions of the African Monetary Fund

28. It is proposed that the African Monetary Fund will perform the following functions:

(1) To undertake monetary and financial co-operation activities as will achieve the quickest pace of African monetary integration and speed up the process of economic integration among member States;

(2) To assist in the formulation of multilateral payments and clearing arrangements among member States;

(3) To use its resources for the purpose of promoting balanced growth of intra-African trade;

(4) To assist, when called upon to do so, in the formulation of economic policy reforms of member States;

(5) To explore channels for enhancing resource availability and provision of credits to member States;

(6) To undertake research and training activities, policy analysis and to provide technical assistance to member States;

(7) To act as a depository and manager of funds entrusted to it by member States, non-member States or any international entity provided that such deposits and management are consistent with the Articles of Agreement of the Fund;

(8) To perform with the prior approval of the Board of Executive Directors such other activities which are not inconsistent with the objectives of the Fund.

c. Technical Operations of the African Monetary Fund

29. The Fund shall carry out the following technical operations which will affect its assets:

'1) Provision of credit facilities to member States for the promotion of intra-African trade;

(2) Provision of an exceptional financing facility to member States to support the adjustment effort associated with unforeseen circumstances;

(3) Provision of a supplementary global balance of payments support to member States;

(4) Investment in Financial assets of different maturities, preferably in prime African financial institutions;

(5) Issuance of guarantees on behalf of member central banks for intra-African balance of payments financing within pre-determined limits and for specified periods;

(6) Undertaking of such other activities as are approved from time to time by the Board of Executive Directors.

30. It shall carry out the following activities relating to its liabilities:

(1) Acceptance of deposits and raising of funds from money and capital markets;

(2) Raising of funds from official sources to supplement its resources;

(3) Raising of such other resources as may be approved from time to time by the Board of Executive Directors.

31. The rationale or need, objectives and functions of the proposed African Monetary Fund discussed above have been suggested on the basis of the theory of monetary funds. However, whether, in practice, the Fund will meet the objectives or not very much depends on the underlying assumptions. Therefore, to adequately assess the chances of success by the AfMF in fulfilling the stated objectives each of the above objectives will be examined:

(1) Implied in the first objective is tence of the need for the fund to ensure stability of and harmonization of changes in exchange rates in order to facilitate smooth intra-African trading environment. But, does the problem of instability of exchange rates existhe first in Africa today or in the near future? Evidence available indicates that 38 African countries have pegged currencies and only 11 are on flexible exchange rate regimes. Thus, the problem here does not really exist. Even if all exchahnge rates were flexible, the Fund will not succeed in influencing the changes in exchange rates because member countries may not bother to consult the Fund when devaluing or revaluing. The reason is that member countries will find it quite rationale to change exchange rates, without bothering to consult the Fund, against currencies of countries with which they have greater volume of trade. And, at this moment, it is with non-members. Thus, on both accounts, the proposed AfMF is bound to be ineffectual until exchange rates are more flexible and intra-regional trade dominates total Africa trade.

(2) The second objective can easily be met but for the Fund to make a significant impact, considerable resources would have to be available on a long term basis rather than short term. The reason is that the current and most pressing economic problem in African is restructuring and diversification of the economies. If the Fund is to provide such development finance, it will simply duplicate the existing regional and sub-regional development finance institutions, which does not make economic sense. In any case, it is extremely doubtful that the member countries will be able to find extra foreign exchange resources for subscription to the Fund. Thus, the effectiveness of the Fund under this objective is doubtful.

(3) When the third objective is considered, it becomes obvious that a regional monetary institution can play an important role which similar national and international institutions cannot assume. However, the institution does not have to be a Fund. It could be a regional payments union for instance. The main point here is that a regional monetary institution has clear comparative advantage in this respect over institutions at any other level. Thus, the AfMF, if and when it is established, will have to fill this gap and could do so effectively.

CHAPTER IV

ORGANIZATIONAL STRUCTURE OF THE AFRICAN MONETARY FUND

32. Based on the experience of the Arab Monetary Fund and the Andean Reserve Fund, it is proposed that the African Monetary Fund shall have the following organizational structure:

a. Board of Governors

33. The Board will be composed of Ministers responsible for finance of member States or their alternates and will be the highest decision making body of the Fund. Their powers will be defined in the Articles of Agreement. Normally, the Board of Governors will meet once a year but they may also call for extraordinary meetings. A quorum shall be constituted by Governors respresenting not less than two thirds of the voting power in the Fund.

34. Voting in the Board of Governors shall be as per the shares held by the respective countries they represent.

35. The Board of Governors shall have the following functions:

(a) to determine the overall policy of the African Monetary Fund and to ensure that the objectives and functions specified in its Articles of Agreement are implemented;

(b) to delegate to the Executive Directors authority to exercise any powers of the Board, except the power to:

(i) appoint and remove he Managing Director and the Deputy Managing Director;

(ii) amend, modify or interpret the Articles of Agreement;

(iii) determine or alter the capital structure of the African Monetary Fund;

(iv) establish, abolish or accept the administration of any special funds;

(v) establish, revise or allocate subscriptions and quotas;

(vi) admit or expel members, or determine the conditions for the admission of new members or expulsion of existing members;

(vii) determine the distribution of the net income of the African Monetary Fund or any other reserves held on behalf of its members;

(viii) determine or establish the remuneration of the Executive Directors, Alternates, the Managing Director and the Deputy Managing Director and approve the salary scales of the general secretariat;

(ix) establish co-operative arrangements with any other organizations, either within or outside Africa, except in implementation of specific assignments or in execution of purely administrative functions entrusted to it;

(x) to adopt its rules of procedure during its meeting.

Board of Executive Directors

36. The Executive Directors shall be appointed by the Board of Governors. They shall be persons who have the necessary technical expertise and experience so as to help further the goals of the African Monetary Fund. The Executive Board shall consist of 9 members.

37. The Executive Directors shall be non-resident and hold meetings on a quarterly basis. Additional meetings of the Executive Board may be called if the need arises.

38. The Executive Board shall be responsible for the policy making of the Fund in line with the general guidelines laid down by the Board of Governors.

39. The Executive Directors will be appointed on the basis of the ADB formula and will vote in the Executive Board as per the voting power vested in them for the countries which they represent. A quorum in the Executive Board shall be as determined by the Board of Governors.

40. The Board of Executive Directors will perform and have the following functions and responsibilities:

(1) to review, direct, control and co-ordinate the financial, technical and other activities of the Fund and conduct business and exercise such other powers as may be granted to it by the Board of Governors,

(2) to approve the programme of activities of the Fund and put into effect the general policies and objectives of the Fund using powers provided for in the Articles of Agreement;

(3) in conformity with the general directives of the Board of Governors, to approve the annual report of the Fund, the country economic reports as well as the recommendations on "economic reformation" and stabilization programmes. The Board of Executive Directors will also take decisions on the provision of financing and guarantees, borrowing by the Fund, interest rates and the size of loans, requests for financing under the various facilities, and other financial administrative and other activities of the Fund.

41. The Board of Executive Directors may set up committees and working groups to perform its functions, and these may comprise Board members and any other competent persons. It will adopt its own rules of procedures. The quorum and voting procedure will be similar to that of the Board of Governors. Each Executive Director can cast all the votes of his constituency.

C. Managing Director

42. The Managing Director shall be the Chief Executive of the Fund and shall be appointed by the Board of Governors. He will preside over Executive Board Meetings. He shall be appointed for a term of office of 5 years, renewable once at the discretion of the Board of Governors or for one term of 7 years. He shall be a person of high integrity

and possessing proven technical experience and ability in the financial field. He should enjoy a high reputation in the financial sector generally. He will carry the following functions:

(i) to conduct the day-to-day functions of AfMF and to direct and supervise other work of the coperational staff;

(ii) to chair all the meetings of the Board of Executive Directors;

(iii) to appoint or dismiss staff of the organization;

(iv) to convene, in consultation with Chairman of the Board of Governors and service the annual meetings and extraordinary meetings of the Board of Governors;

(v) to perform any other functions assigned to him by the Executive Directors or the Board of Governors.

d. Deputy Managing Director

43. The Deputy Managing Director or Directors may be appointed as and when the need arises.

e. Specialized Technical Committees of the African Monetary Fund

44. The Board of Governors may establish a Committee or Committees to deal with specific issues.

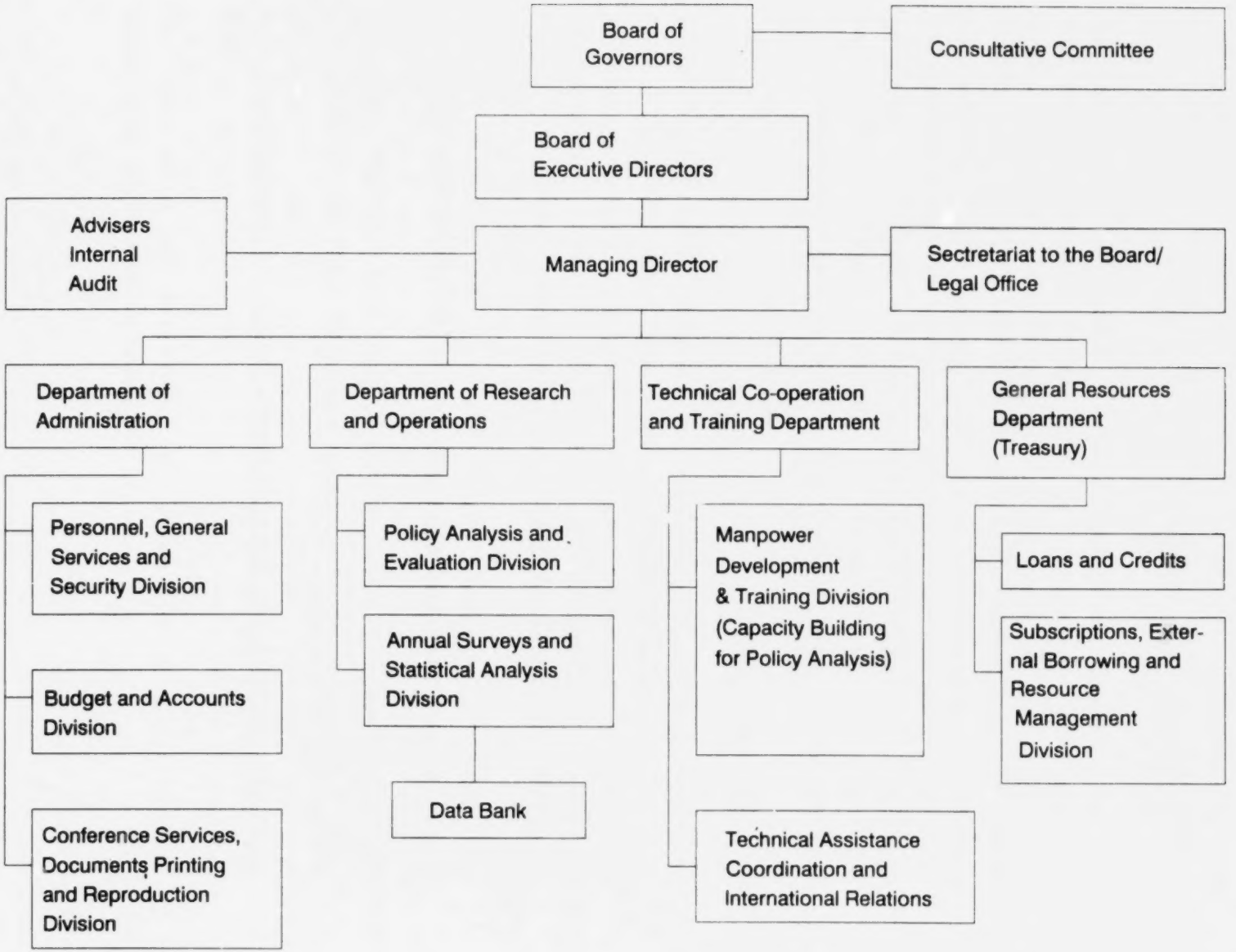
f. Membership and voting

45. An African state which is a member of ADB shall be eligible for membership of the AfMF. Membership of the Fund may also be open to non-regional members. The voting power of each member of the Fund should be in accordance with the agreed formula of the ADB. Votes shall be allocated to member States in proportion to their subscriptions or quotas. The non-regional participation shall be approved provided the voting power in the Fund shall be such that African States shall retain two thirds of the voting power.

g. The Secretariat

46. The Fund shall start with a skeleton staff but it shall have the necessary manpower to start operations. It will consist of a Board Secretariat/Legal Officer, Special Advisers, Internal Audit and four specific departments, as specified in the following organizational chart.

47. These departments will not all be created at the beginning but when the need arises.


Board of Governors
Consultative Committee
Board of Executive Directors
Advisers Internal Audit
Managing Director
Sectretariat to the Board/ Legal Office
Department of Administration
Department of Research and Operations
Technical Co-operation and Training Department
General Resources Department (Treasury)
Personnel, General Services and Security Division
Budget and Accounts Division
Conference Services, Documents Printing and Reproduction Division
Policy Analysis and Evaluation Division
Annual Surveys and Statistical Analysis Division
Data Bank
Manpower Development & Training Division (Capacity Building for Policy Analysis)
Technical Assistance Coordination and International Relations
Loans and Credits
Subscriptions, External Borrowing and Resource Management Division

CHAPTER V

FINANCIAL RESOURCES OF THE AFRICAN MONETARY FUND

a. Introduction

48. The main purpose of this chapter is to present the financial viability of the proposed African Monetary Fund (AfMF). It starts with determination of the size of the Fund and the flow of payments of subscriptions. Then 5-year projections of the income and expenditure, the balance sheet and the cash flow statements are made. After this, the investment policy of the Fund, the capacity of the AfMF to borrow, and the prospects for mobilizing external resources are assessed. The possibility of special facility funds is investigated before concluding with an evaluation of the financial viability of the AfMF.

49. Reference will be made (as instructed in the Guidelines for this study) to the structures and experience of existing Third World monetary funds such as the Arab Monetary Fund (AMF), the Central American Monetary Stabilization Fund (CAMSF), and the Andean Reserve Fund (ARF). In addition, where appropriate, reference to the Bank for International Settlements (BIS), the European Monetary System (EMS) and the International Monetary Fund (IMF) will be made.

b. The size of capital of the fund

50. Assessment of the required resources for a Monetary Fund is a complex issue. The experience of the AMF and the ARF is that the initial size of the capital of these institutions was determined mainly by the availability of foreign exchange resources in regional member countries. There was, therefore, no scientific method used to determine

the size of the respective funds. However, available funds may be so little as to make insignificant contribution to adjustment efforts of member counteis. Thus, in addition to the availablity and willingness by member countries to contribute, the likely impact of the Fund on economies of adjusting countries need to be taken into account.

51. The fact that the IMF and World Bank, for example, are able to influence programmes of adjustment of member countries is basically because of the size of finance they can offer and the quality of economic policy advice they can provide. Similarly, the ability of the AfMF to influence adjustment programmes for its members will critically depend on the average size of its credits relative to the balance of payments needs of the countries as well as its capacity for economic policy analysis and advice.

52. There are two approaches to quantifying the significance of the AfMF's operations. One indicator is the proposed size of the AfMF as a percentage of the cumulative purchases ($5667 million) by African countries from the IMF between 1983 and 1987, a period of the most severe crisis. As table 4 indicates, this gives 52.9 per cent, 35.3 per cent and 17.6 per cent, respectively. Another ratio suggested by a confidential study on another proposed regional Monetary Fund is that of the size of the AfMF to the size of the African quotas ($ 6 066.7 million) at the IMF, and, one third of the quotas would be regarded as adequate. As the Table 4 shows, an AfMF size of $2.0 billion and $3.0 billion would be adequate according to both approaches while $1.0 billion would not have significant impact.

Table 4

The size of the AfMF as a percentage:

Size of the Fund	Cummulative purchases from IMF, 1983-1987	African Quotas at the IMF
$ 3.0 bn	52.9	49.6
$ 2.0 bn	35.3	33.0
$ 1.0 bn	17.6	16.5

53. The point being made here is that, the $3.0 billion or $ 2.0 billion size of the proposed capital of the AfMF can be regarded as significant and the Fund should have an important impact on the African member countries as well as credibility in the international financial markets. There is no reason, therefore, why the Fund should not be able to influence acceptable economic adjustment programmes of its borrowers. However, a reduction in the size to $1.0 billion would significantly reduce the impact of the proposed Fund. For a start and if only small member countries receive financial assistance from the Fund, paid-up subscriptions of $1.0 billion would make some impact on the borrowing members.

54. For the African Monetary Fund to have a significant impact on African economies, it is proposed that its authorized capital should be US$2 billion and that the paid-

in part of it, irrespective of whether non-regional members join in or not, over the five years immediately after the establishment of the Fund should be $1.0 billion. The called-up capital of the Fund should be fully paid in convertible currencies for reasons given below.

(i) The case for 100% contribution in convertible currencies

55. This approach has been adopted by the ARF and CAMSF. The rationale behind this decision is that regional member countries have large deficits with non-regional countries and very small deficits within the region. Since intra-African trade constitutes less than 5 per cent of total African trade, the probability that well over 90 per cent of the deficits of African countries would be with non-regionals is very high. If that is the case, then contributions to the capital resources of the AfMF should be in convertible currencies. Even in the case of intra-regional trade, under a clearing arrangement, the net position will have to be settled in convertible currencies. Thus, in the view of the AMF, ARF and CAMSF officials, and indeed that of other experts, until regional currencies are convertible, it is virtually meaningless to include them in the contributions to the Monetary Fund.

56. It should be observed, however, that the AMF did initially accept inconvertible national currencies as a way of reducing the foreign exchange burden for the member countries. Further, this portion of contributions was intended to be used in the settlement of regional transactions when such a mechanism exists. In fact, twelve years after

its establishment, the AMF has not yet solved the problem of use of incovertible national currencies. As a result, during the subsequent increase in its capital, the AMF excluded contributions in national currencies.

57. When the ADB was established, all payments to its capital were in either gold or convertible currencies. During the third capital increase of the Bank, local inconvertible currency contributions were permitted but during the fourth increase, these currencies were excluded. As of today, the ADB as well as the Inter-American Development Bank have concluded that the inconvertible national currency contributions to their respective capital have little, if any, significance at present. Even in the case of the IMF which accepts 75 per cent of contributions (quotas) in national currencies, that part of total national currency contributions which is usable is very small indeed (about 34 per cent) and the rest is completely idle, with no investment income for the Fund itself.

58. For the above reasons, it is considered virtually meaningless for the AfMF to receive inconvertible national currencies, at least at the beginning and until further studies have been carried out on use of such currencies. Thus, it is assumed here that all contributions will be in forex and that interest income can be earned on the whole amount, whether invested or lent out in Balance Payments Credits.

(ii) The flow of payments of called-up capital

(ii) The flow of payments of called-up capital

59. Various scenarios for calling in subscriptions from members were considered taking into account: the capacity to pay, the need for the Fund to make an immediate and important impact on borrowing countries (initially small borrowers), the need for immediate recognition in the financial community and above all, the need for regional member countries to demonstrate their commmitment and seriousness in the project. Given the above factors, table 5 shows three scenarios which were considered most appropriate for phasing the payment of called-up capital.

Table 5

Payments of Called-up Capital

Scenario	Year 1	Year 2	Year 3	Year 4	Year 5
I. Per cent of called-up capital	40	15	15	15	15
Amount ($ million)	400	150	150	150	150
II. Per cent of called-up capital	30	25	20	15	10
Amount ($ million)	300	250	200	150	100
III. Per cent of called-up capital	30	10	15	20	25
Amount ($ million)	300	100	150	200	250

60. Largely influenced by the need for immediate impact and recognition in financial markets and the donor community, scenarios I and II, which result in at least $500m or half of the called-up capital being paid in the first two years of the 5 year period are recommended with scenario II being

recorded as the better. However, scenario I offers members a greater relief than II after the first year of payment. The rationale for suggesting scenario III is that the first payment may have to be made during conditions of foreign exchange shortages. Once the first payment is made, members would have greater relief in the second year and as the economic and foreign exchange situation improves over the next three years, payments could be escalated. Thus, this scenario weighs heavily on the capacity to pay considerations.

61. A larger amount of financing than that provided for in the subscription amounts will be required under the current conditions prevailing in Africa. However, member countries' ability to subscribe to the capital of the Fund in the prevailing conditions on the African continent was taken into consideration. Keeping these factors in view but also bearing in mind that the African Monetary Fund will need to have a minimum impact in redressing the current situation, the subscriptions have been proposed as above. These subscriptions will be used by the Fund to support the following activities:

a. Short-term facilities;
b. Exceptional facilities
c. Stand-by arrangements
d. Administrative expenses

(iii) Projections of income and expenditure, cash flow and balance sheet statements

62. Details of allocation of subscriptions and projections of the above statements for the first 5 years of operation

of the proposed Fund and the assumptions underlying the results are spelt out in the annex to this study.

c. The investment and reserve policy of the AfMF

63. As with other monetary funds, the investment policy of the AfMF would have to be based on the four principles of safety, liquidity, profitability and reciprocity. These principles are not new. However, if the Fund is to mobilize external resources eventually and play a significant role in the balance of payments financing of member countries, these criteria should be adhered to at all times.

64. The liquidity of the Fund's assets would have to be high enough to enable it to create confidence in it by international banks and member central banks and to meet its obligations to member countries and creditors promptly. The Fund is expected to deal with reputable financial institutions in the financial markets, in order to ensure safety of its investments. The degree of profitability of the Fund will greatly influence its capacity to attract external resources. The net income would have to be employed in building up the capital subscription of the member countries - an important factor taken into account in credit rating by creditors. This criterion of viability rules out subsidization of interest rates on credits. The Fund would, finally, need to establish very close ties with reputable international banks and central banks (including member central banks) and to secure reciprocity with such institutions. By this is meant ability to secure external

resources at more favourable terms from those institutions in which the Fund invests its resources not immediately available for lending. Unless this reciprocity is sought, the Fund could find itself placing more deposits with international banks than it is able to borrow from them.

65. Reserves of a monetary institution constitute part of its own resources. As such, the amount of reserves enhances its creditworthiness. The desired rate at which reserves are built-up will depend on management decision which in turn will be influenced by the initial size of capital and the ease with which additional capital subscriptions can be secured from member countries. In the case of the AfMF, where increases in capital subscriptions are likely to be difficult, the management will need to build-up reserves immediately and very rapidly thereafter. The actual rate of accumulation of reserves may also depend on the level of interest and other charges on balance of payments credits and interest on investments. Thus, after setting a desirable target rate of reserve accumulation, the rate of interest on credits could be determined accordingly. It may be useful to note that the IMF management has recently decided that reserves shall grow at 3 per cent per annum. Interest adjustments are made to achieve this target.

d. External Resource Mobilization

(i) The capacity of the AfMF to borrow

66. This section is concerned with an examination of the capacity of the AfMF to borrow funds, both internally and

externally. The possibilities for borrowing are discussed in detail in section III below. It is, therefore, proposed to start with an analysis of the factors which determine the capacity of a monetary fund to borrow. This is then followed by forecast of the amounts which the Fund could raise through borrowing.

(ii) Factors determining the capacity to borrow

67. The amount of subscribed capital stock and the credibility of the shareholders of an institution generally determine its capacity to borrow additional funds 10/. Theoretically, the amount that could be raised through borrowing is equal to that part of the convertible currency callable portion of subscription capital. In the case of a long established development finance institution with a proven record, the ratio of paid-in to callable capital need not be very high. But in the case of monetary Funds, the whole amount of the subscribed capital in convertible currency must be paid-in and it is this which determines how much could be borrowed. For example, the AMF is permitted by its statutes to borrow up to twice its authorised capital and general reserves. As at the end of 1982, some 80 per cent of the authorised and subscribed capital was paid-up. In practice, however, AMF has not used this provision. The ARF on the other hand does not have this statutory limit on borrowings. However, the paid-in capital constitutes

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30/ It is important to note that, for the AfMF, it is the convertible currency part of the subscriptions which would matter in credit rating and not the local currency component.

97 per cent of authorised and subscribed capital. According to the ARF officials, it has been very difficult for them to achieve a debt to paid-in capital ratio of 1:1. For the IMF, the ratio of debt to quotas was 0.3:1 in 1982 and 0.3:1 in 1983 11/. These ratios suggest that during the initial years of the AfMF, it may be extremely, if at all possible, difficult to raise external loans of significant amounts. This is the reason why the previous financial projections were based on own resources alone.

68. The management and financial performance of the AfMF also enter the credit rating exercises. This aspect will only be important after a few years of operations. However, sound financial management and liquidity of the Fund in the early years could greatly improve its capacity to borrow in future.

(iii) Projected Borrowing by the AfMF

69. For the purpose of this study, it will be assumed that the AfMF will adopt a rather passive or conservative attitude to borrowing until the institution has matured and established its reputation in international financial circles. Thus, after the first five years of operation, the Fund could be restricted to borrowing an amount not exceeding 50 per

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11/ According to the Executive Board Decision No. 7040 (82/7) January 1982, borrowing plus unused lines of Credit will not exceed the range of 50 to 60 per cent of the total IMF quotas.

cent of its subscribed and paid-in capital. This could generate additional resources of $ 500 million, $ 1,000 million and $ 1,500 million depending on the size of the Fund. However, in practice, the AfMF may find it extremely difficult to raise this amount for reasons given in section II below. It is instructive to note that the ARF was not able to raise the ratio of borrowing to paid-in capital and reserves to over 50 per cent until after 5 years of operations. Currently, this ratio stands at 22.4 per cent, about 35.3 per cent of which is accounted for by borrowing from member central banks in form of fixed deposits and promisory notes 12/.

The necessity and possibilities of obtaining external finance to supplement subscriptions by member countries

70. According to the principle of balance of payments financing by a regional monetary fund, there must exist within the region enough surpluses to finance deficits. This is why the IMF functions relatively smoothly in financing world deficits. This may be true with respect to intra-African trade which constitutes about 5 per cent of total African trade. The bulk of the deficits of all African countries is with non-regional countries, it is extremely difficult to see how such a fund can operate, unless non-regionals are admitted.

12/ ARF, Fax message, 23 May, 1989.

71. An examination of the international reserve situation of most African countries shows that these countries do not seem to have extra reserves which they can use to subscribe to the proposed AfMF. It is generally agreed that the minimum level of reserves that should be regarded as adequate is 2 months' worth of imports. From Table 6, it is clear that most African countries do not appear to have extra foreign reserves with which to contribute meaningfully to the AfMF. Most of the countries for which information was available had reserves of less than 2 month's worth of imports. Although the situation appears to have improved by 1986, the reserves must have been accumulated at the expenses of imports of capital goods. As a result, many of these countries are finding it difficult, if not impossible, to raise foreign reserves for subscription in full to existing institutions such as the ADB, ECOWAS, PTA, the Common Fund for commodities, just to mention a few.

Table 6
Frequency of Gross International Reserve Holding in Months of Import Coverage

Reserve Holdings	1981	1982	1986	1988
	(percentage)			
Less than 2 months worth	68	67	58	
2-3 months worth	12	13	21	
Over 3 months worth	20	20	21	
Total	100	100	100	
Number of countries	25	30	38	

Source: World Bank, World Development Report, 1984 and 1988.

72. In the absence of meaningful recovery only a drastic cut in the import bills could release the necessary foreign exchange resources for contribution to the AfMF. However, it must be recognised that the opportunity cost of diverting these resources to the AfMF would be the reduction in essential imported capital goods and raw materials, investment and growth in output and employment. It is possible that most African countries have exhausted their capacity to reduce imports further as can be indicated by rising accumulation of payment arrears. In that case, additional resources must be found externally. Several alternative sources of such resources are examined below. These include voluntary deposits by African institutions, grants, loans (including concessional) and subscription resources from non-regionals.

Deposits from African Central Banks and Regional Financial Institutions

73. Some of the reserves of member central banks are currently held with foreign Central Banks, the Bank for International Settlements and international private banks. Should the Fund be able to offer competitive terms, there is no convincing reason why at least a small proportion of such funds could not be attracted by the AfMF. For example, the ARF has recently issued attractive short-term fixed deposit instruments to its member central banks at

9.25 per cent to 9.8125 per cent per annum. When these rates are compared with the interest earned by the Fund on its investments of between 8.375 per cent and 9.8125 per cent, these instruments are indeed competitive. As a result of this innovation, the ARF had mobilized US$153.4 million as at 30 June, 1984 and US$140.6 million as at 31 December, 1987 13/. These funds constituted 47 per cent of the paid-in capital of this Fund in 1984 and 30 per cent in 1987. The AMF had no borrowings from member central banks or from external sources as at the end of 1987 and 1988.

74. Estimates of the likely volume of Central Bank deposits which the AfMF could attract can only be made after responses from selected African Central Banks. Preliminary investigation, however, indicates that the AfMF would be able to attract deposits from the Central Banks. Regional and sub-regional African financial institutions and marketing organizations also may have surplus foreign assets held in international financial centres. There seems to be good reason to expect part of these resources to be deposited with the AfMF on competitive terms. Here we have in mind the African Development Bank Group, Africa-Re, Shelter-Afrique, Sub-regional Finance Institutions, and marketing organizations. This will depend on availability of surplus funds, willingness to release them and the attractiveness of the instruments offered by the AfMF.

13/ ARF, Fax message, 23 May, 1989.

75. The ADB, which is not a monetary institutions, did manage in 1975 to raise $13 million from Central Banks in the form of 2-year bonds. This alone constituted about 6 per cent of the paid-up capital of the Bank. Currently, the amount from this source stands at $60 million, of which 52.5 per cent is accounted for by African central banks. It is, therefore, not unrealistic to expect the AfMF to eventually raise as much as this amount. For the purpose of this study, it should be possible for the Fund to eventually raise an amount which is at least 10 per cent of its paid-in subscriptions, that is $100 million, $200 million and $300 million, depending on the size of paid-in capital.

(vi) Grants

76. Given the underdeveloped nature of most African countries, the AfMF may be able to secure grants from developed countries. It may be worth noting that the AMF, ARF and CAMSF have not yet received such funds since commencement of operations. The main reason given by the ARF and CAMSF was that they had not yet taken the initiative to solicit for grants. It was also felt that soliciting for grants could be regarded by creditors as a sign of weakness. However, trends in the flow of these resources to developing countries indicate that it has become increasingly difficult to raise these types of funds. Difficulties of replenishing IDA are well known. If and when the AfMF is established, the management could approach non-regional countries for grants to supplement member

countries' subscriptions or indeed to assist poorer member countries to subscribe to the Fund. The latter assistance has already been granted to certain African countries for subscription to the Common Fund for commodities. The fact that the majority of the world's least developed countries are in African and that donors have shown considerable sympathy for these countries, the prospects for securing some grants for the AfMF appear to be good.

(vii) Concessional and non-concessional loans

Concessional loans

77. In addition to grants, it may be possible to obtain loans on concessional terms; that is, loans at interest rate well below market rates and with long repayment periods. The CAMSF was able to raise US$10,000,000 from US AID at 3 per cent per annum for 20 years, with a 9-year grace period. The condition for this soft loan was that the profits made should be distributed among member countries in the form of additional subscriptions to the capital of the Monetary Fund. It is reasonable to expect that this type of loans could also be secured by the AfMF.

78. Possible sources of concessional loans which could be approached are governments development institutions (such as UK Overseas Development Administration, European Development Fund, USAID) in both market and socialist developed countries. The experience of ADB was that it could not turn to external sources of finance until 1973,

thus ten years after establishment. When it did, the first resort was loans of about US$12 million from foreign governments. However, this source dried up as donors' preference was for direct lending to African countries. Thus, of the total amount for the 30 borrowings by ADB between 1973 and 1982, only 5 per cent was foreign government loans and floatation of bonds subscribed by foreign Central Banks. The rest, 95 per cent, was from the private markets.

79. Third World countries, particularly OPEC members, could also provide concessional loans. Of the US$919.7 million made available to African countries from the OPEC Fund by 1982, 43.1 per cent or US$396 million was in the form of balance-of-payments loans. If these loans were made available to Africa in the absence of a balance of payments financing institution, it is quite reasonable to assume that once in operation, the AfMF should be able to raise similar funds from the OPEC Fund. During the mission to EMS, a certain amount of sympathy with Africa's determination to work towards monetary economic integration was observed. There is a good chance that these sentiments could be translated into concrete action.

80. Putting all the above sources together, it is expected that the AfMF would be able to mobilize an amount of concessional loans of at least $300 million over a five-year period, most likely after the first five years of operations. However, the most important requirement that would have to be met is the ability of the AFMF to produce credible and defensible adjustment programmes with adequate conditionality.

Non-concessional loans

81. The Fund could, after several years of successful operations, also supplement members' subscriptions with non-concessional loans - that is short- and long-term loans at market rate of interest. However, the experience of other monetary funds studied shows that market borrowing has become extremely difficult. The ARF in particular pointed out that it was extremely difficult to borrow beyond the Fund's liquid investments. This situation was expected to continue for a long time. The reason for this tight credit situation is not, of course, lack of loanable funds in the world but lack of confidence by creditors in debtors. Indeed, there has been a sharp decline of international private lending, particularly to Latin America and Africa, the two regions which have been more severely affected by debt crisis. The situation is most likely to be worse for a new institution with virtually no track record.

82. However, as a regional financial institution, the AfMF should, in due course, be able to mobilize these market funds at a spread above LIBOR smaller than the spread paid by individual central banks. Many African countries cannot even have access to these markets. Thus, the Fund could play a very significant role in inducing the flow of market funds for member countries' balance of payments financing. Indeed, the ARF has succeeded in playing this role of intermediary for the benefit of member countries. This

been possible not because the ARF is a regional institution with international legal standing but mainly because this Fund is managed as a technical institution whose driving force is guided by the principles of safety, liquidity, profitability and reciprocity.

83. The ability to attract external funds is also influenced by the extent to which the monetary fund enforces conditions for use of its resources. It should be stressed that most creditors would not lend money to a monetary fund (for balance of payments financing) which does not enforce acceptable conditionality. Thus, the AfMF would have to design and enforce policy conditions for the use of its resources, if it is to succeed in mobilizing external funds, from both private and official sources.

84. As a summary, the possibilities of raising external loans by the AfMF exist, provided that the conditions discussed above are met. However, it is not going to be easy at all and it would be advisable not to rely too heavily on non-concessional loans which in any case will be very expensive for most member countries. For these reasons, this study has assumed that the AfMF will not be able to borrow on the market for several years after establishment.

(viii) The opening of subscriptions to non-regional countries 14/

85. The possibility of member countries failing to meet their convertible currency subscriptions in full cannot

14/ This option was not included in the terms of reference for this study. However, the idea was included here simply to give the decision-makers more options from which to choose. It may turn out to be the most feasible solution, if the ADB's experience is a guide. Further, it is of interest to note that the ARF and the CAMSF are thinking along these lines.

be overemphasized. As already mentioned, many African countries cannot pay their contributions in full to existing regional and international institutions. Grants and loans cannot be relied on, particularly during the initial years of operation of the Fund, as already noted above.

86. Since most African countries have balance of payments deficits with non-regionals, it is suggested that the latter should be invited to subscribe to the Fund without the right to draw from it, as is the case at the ADB. It is possible that few non-regional countries would be willing to contribute to a monetary fund without the right to draw on it. The main reason is that balance of payments financing is reversible while development financing is not. This means that a surplus country may not wish to contribute to a monetary Fund unless that country can draw on the Fund if and when the surplus turns into a deficit. In that case, it could be argued that African members would stand to gain if the AfMF could permit non-regionals to have limited access to its resources as long as the African character of the Fund is maintained. This is unlikely to be attractive to the non-regionals because they may prefer to continue to support and draw from the IMF in which they have greater voting power and access to larger resources.

87. However, if and when the AfMF is well established, the management should be encouraged to actively pursue this alternative source of external resources. The success of the ADB on this issue is one important reason for optimism. If the same proportion of two-thirds of voting power is

maintained by African members and one-third by non-regionals, the proposed $ 3 000 million capital could be raised to $ 4 500 million if the latter group of countries was permitted and willing to join the AfMF without drawing from it or with limited access. It is unlikely that a developed non-regional member would request support from a monetary fund designed to serve the interests of the poorest countries in the world.

e. Special facility funds

88. The idea of special facility funds is meant to meet the needs of some countries with balance of payments problems arising from special and emergency circumstances or other factors completely out of the control of the member countries. In the case of Africa, there are 28 countries classified as least developed and 22 debt-distressed. A case can be made for special treatment of such countries. These criteria are recognised by the international donor community and could be adopted by the AfMF. Thus, there is a need for special facility funds or special treatment of some members within the AfMF.

89. Special facility funds, if they are to meet their objectives, must be secured at very concessional terms and conditions. The type of funds the African Development Fund raises from time to time would be most appropriate for this purspose. Thus, the main source would be grants and exceptionally low interest funds. In the first place, some wealthier African Governments could be expected to give grants to the Fund for this purpose. The Federal Republic of Nigeria has taken the lead by establishing the Nigeria Trust Fund within the ADB Group. There is no reason why similar offers of solidarity should not be made to the special funds within the AfMF as economic recovery materializes and becomes sustained.

90. There is growing evidence that the developed countries are bending backwards in an effort to meet the financial needs of the least developed and debt-distressed countries. For example, examination of the growth in ODA by economic class of countries shows that since 1975, least developed countries have increased their share of ODA. The main multilateral aid agencies such as the European Development Fund, UNDP, etc;, could be approached for this purpose.

91. Thus, it can be expected that when and if special facility funds are established within the AfMF, necessary funds are expected to be forthcoming, but perhaps not in sufficient volume to support required stabilisation and adjustment in the relevant countries.

92. As for the timing, it may be wise to postpone the establishment of special facility funds until the Fund has established its credibility in the financial community. This is not likely to happen within the first few years of the life of the AfMF. However, the provision to establish special facility funds needs to be included in the articles of agreement if and when it is decided that the AfMF should be established.

f. Conclusions and recommendations on this Chapter

93. The principal aim of this chapter has been to investigate the financial viability of the proposed AfMF for the first five years of operations. The analysis has included the

availability of resources and the profitability of the Fund. The study has assumed that the Fund's main income generating activity is balance of payment financing and investment. This assumption is based on the experience of other third world monetary funds. Other minor functions have been assumed not to bear significant results on the financial statements of the Fund.

94. The size of financial resource requirements and the flow of payment of subscriptions suggested in this study take into account the capacity by member countries to contribute and the desired impact on borrowing countries. The chapter also assumes that the Fund will not borrow during its first years of operations. Instead, the Fund will be expected initially to rely entirely on its own capital resources as has been the case with other third world monetary funds.

95. Given the amount of own resources indicated in this chapter and if the administrative budget suggested here is adhered to, the analysis in this chapter indicates tentatively that, the Fund is likely to realize a positive real rate of return on paid-in capital. The liquidity of the Fund appears adequate enough for it to establish its credibility over time.

96. The $ 1 billion case seems to be the more feasible from the capacity to pay point of view. However, the significance of the impact of the Fund on member countries would be enhanced if the size of the Fund was at least $ 2 billion. The Fund could, therefore, be established with

an initial capital size of $ 1 billion and allowed to grow to $ 2 billion or $ 3 billion during and/or after the first five years.

97. There are many ways in which the Fund could speedily be implemented in the event of a shortfall in the initial capital subscriptions. The options that could be considered are summarized as fcllows:

(1) Borrowing from regional member countries;
(2) A line of credit from the ADB;
(3) Borrowing from capital markets;
(4) Securing grants and concessional financing from official and multilateral sources;
(5) Borrowing from non-regional members;
(6) Immediate admission of non-regional members and calling-up all their capital.

It is, however, considered imprudent to have recourse to such optional financing until the Fund became, on its own, a viable institution. Thus, no such financing could be considered in the initial stages. Members will necessarily have to show their commitment to the project before resorting to these options.

CHAPTER VI

BROAD GUIDELINES ON LENDING POLICIES OF THE FUND

98. In setting out the general criteria for financing, the AfMF would take into account the prospective borrower-specific characteristics and the economic policies it intends to pursue to correct its imbalances. The borrower-specific characteristics such as per capita income, level of foreign reserves, level of debt owed to the AfMF, credit ratings, membership status to the AfMF, quotas etc. should help determine the conditions of drawing, the interest rates and other charges. Adherence to agreed economic policies may require the AfMF to specify some economic criteria to be achieved over a period of time. The aim is for the AfMF to follow rigorous standard to gain credibility and inspire the confidence of its members and the international donor community. The following are some broad guidelines on the lending policies of the Fund.

99. As the AfMF might start with modest resources, it would have to lay down the conditionalities governing the general use of its resources for the following specific functions:

A. Short-Term Credit Facility for Clearing Houses

(a) This facility would finance deficits of African countries experiencing settlement difficulties because of problems of seasonal or cyclical nature with short-term effects. The volume

of financing would be proportional to the applicant's total trade through the clearing house, the resources available under this arrangement and the country-specific characteristics

(b) The use of this facility would be subject to the AfMF cost of new capital plus a margin. In the case of the least developed members, the interest charge may be equivalent to the AfMF current cost of capital plus a margin.

(c) The use of this facility would be subject to a report on the measures adopted to liberalize intra-African trade.

(d) The AfMF would guarantee payments to the creditor country but the debtor country would accept counterpart liabilities to the AfMF and would agree to make repayments (up to 3 years for least developed countries and up to 2 years for others) 15/. The liquidity of the facility could be enhanced by inviting interest-bearing contributions and deposits from developed countries, donor agencies, and so on.

15/ The periods and/or conditionalities shown in brackets are suggestions only, they have to be re-examined by the relevant authorities when the Fund is established.

B. Medium-Term Credit Facility for Clearing Houses

(a) This facility would finance deficits of African countries experiencing settlement difficulties because of problems of seasonal or cyclical nature with medium term effects.

(b) Lending conditions such as the volume of financing, the interest rates and the conditions for drawing would be similar to those for short-term financing except that the maturity would extend to 5 years in the case of the least developed countries and 3 years for others.

C. Stand-by Financing Arrangements

(a) This facility would provide assistance to countries facing balance of payment difficulties arising from the destruction of their production as a result of persistent drought, exhaustion of mineral deposits and any other exogenous factors. The volume of financing would cover a certain proportion of the damage inflicted or the losses recorded by the applicant as well as the resources available under this facility and the country-specific characteristics.

(b) Lending conditions, namely, the interest rates and the conditions of drawing would be similar to those of the medium term credit facility in

addition to AfMF being satisfied that the economic policies adopted are adequate to correct the imbalances. (The maturity of the loans would not exceed 6 years in the case of the least developed economies and 4 years for others).

D. Balance of payments Financing Facility

(a) The primary function of this facility will be to extend resources to member countries facing balance of payments problems arising from exogenous and temporary short-falls in export earnings or high import prices in the presence of limited foreign exchange reserves. The volume of financing export earning shortfalls would be established by a comparison of average earnings for the twelve-month period preceding the application with average earnings over a three-year period before the year of application. The volume of financing high import prices would be similar to that used in defining export shortfalls.

(b) Lending conditions, namely, the interest rates and the conditions for drawing would be similar to those of the stand-by arrangments except that the maturity would not exceed (5) years in the case of the least developed economies and (3) years for others.

E. Food Import Financing Facility

(a) This facility would assist AfMF members in financing food imports necessitated by emergency for unforseen

conditions such as bush fire, flood, locust invasion, war and enable countries to cope with steep rises in import prices of basic cereals. This facility would give priority, as far as possible, to cereals imports from African markets in order to promote intra-African trade. This facility would also finance deficits arising from normal clearing and payments operations involving intra-African or subregional trade in food; this could also be extended to cover items needed to increase domestic food supplies.

(b) The maximum amount available to a country under this facility would be determined by factors such as its predetermined quota in AfMF, its level of economic development, the resources available under this facility and the seriousness of the food shortage coinciding with a substantial decline in its foreign exchange.

(c) Lending conditions such as interest rates and conditions for drawing would be similar to the short and medium-term credit facility for balance of payments problems except that the maturity would not exceed 4 years in the case of the least developed economies and 2 years for the others.

F. Facility for Financing Limited Convertibility

(a) This facility would assist AfMF member to purchase another's currency in exchange for its own, for use in payments for legitimate transactions. Since this facility would enhance a greater utilisation of the clearing mechanisms, the volume of financing under this facility would be proportional to the applicant's total trade through the clearing house, the resource available and the applicant's level of economic development. A country may also purchase such amounts of its own currency held by the AfMF exceeding its quota holding as determined by the Articles of Agreement.

(b) Other lending criteria, namely, the interest rates, the maturity and the conditions for drawing would be similar to that of the short-term credit facility for the clearing houses.

G. Some Specific Guidelines

(i) The eligibility of a member to Fund facilities would be subject to the provisions that the member should not be in arrears on both capital subscriptions due and outstanding credits. The member should also establish a prior financing need;

(ii) The access of a member to Fund facilities would be related to the member's quota in the Fund,

its existing level of use of IMF facilities as well as its eligibility to the facilities of the ADB:

(iii) The Executive Board shall from time to time determine the conditions governing the use of Fund resources with a view to establishing that the overall lending by the Fund is at all times reasonably constrained by its evolving resources position;

The credits granted by the Fund shall be bounded as follows:

- 0.25 to 0.45 times the respective paid-in contributions for member whose quotas are US$... million or larger;

- 1.5 to 1.75 times the respective paid-in contributions for members whose quotas are less thant US$... million.

(iv) The Fund shall at all times so deploy its resources as to preserve an acceptable degree of liquidity of its resources;

(v) The Fund may borrow in amounts for lending purposes such that the ratio of its borrowed resources to its subscribed capital does not exceed two to one. It will also issue guarantees bearing in mind a reasonable capital adequacy ratio for its commitments.

PART II: ALTERNATIVES

CHAPTER VII

TRANSFORMING THE ACMS TO BECOME A NUCLEUS OF AN AFRICAN MONETARY FUND

Comparison of the AfMF with the Present ACMS

100. It has been suggested that a feasible approach to the creation of an African Monetary Fund would be initially the strengthening of the African Centre for Monetary Studies so that it might have a much more enhanced, a more country-specific role in analysing Africa's monetary and related difficulties and in assisting countries in formulating alternative policy options to those advocated, for instance, by the IMF, on the basis of which they can negotiate and obtain external resources in amounts and terms more responsive to their problems. Therefore, initially the provisions of balance of payments finance, a necessary complementary function, would have to be obtained from existing African institutions. The purpose of this section is, therefore, to examine specifically the objectives, functions, strategies and structure of the African Centre for Monetary Studies and suggest how they can be modified to make the institution the nucleus of an African Monetary Fund.

a. The objectives

101. The objectives of the African Centre for Monetary Studies and those proposed for an African Monetary Fund are as follows:

THE OBJECTIVES OF THE ACMS	THE OBJECTIVES OF AN AfMF
1. To promote the economic development of African economies through the better understanding of banking and monetary matters as instruments of economic development.	1. To assist member states to formulate sound monetary and financial policies which are conducive to stronger real economic growth both at the national and regional levels.
	2. To assist member countries in creating an enabling environment which fosters viable and efficient financial monetary systems.
	3. To provide a forum for consultation, co-ordination and collective action on regional and global monetary and financial issues.
	4. To assist member states settle, initially intra-regional balance of payments deficits, and eventually global balance of payments deficits.

b. Functions

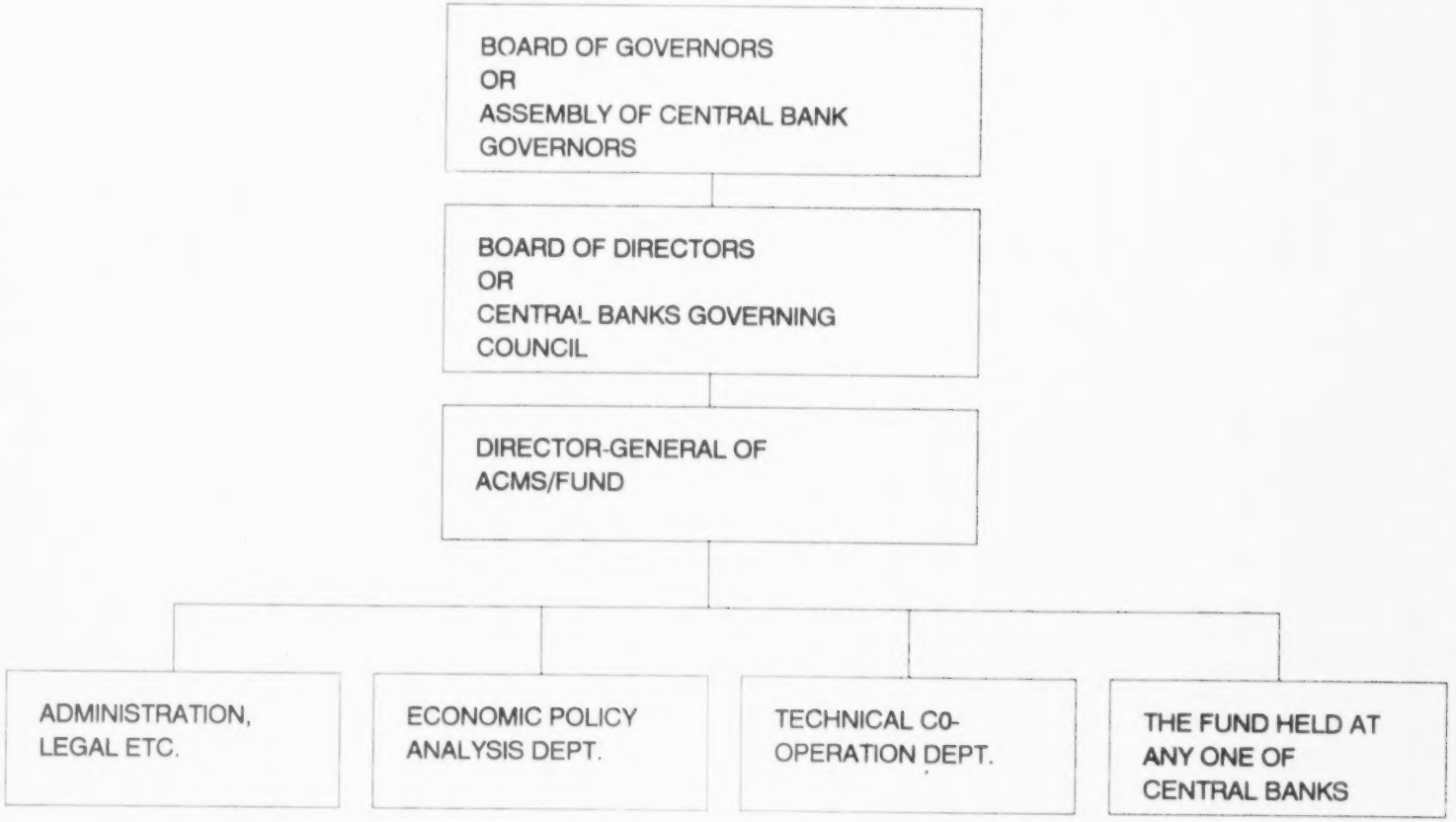
102. The strong similarity between the objectives of the Centre and that of the AfMF in its initial stages is also brought clearly by a comparison of the functions of the Centre and those proposed for an AfMF as shown below:

FUNCTIONS OF THE ACMS	FUNCTIONS OF THE AFMF
1. Study on a continuous basis monetary problems of African countries and the impact of international monetary developments on African economies with a view to enabling African countries promptly to formulate their own proposals on a regional basis and to ensure that the international monetary system does not work against the interests of African countries.	1. To follow international economic research, particularly on Africa, and provide counterpart publications consisting of commentary, applied research methods, literature surveys and specialized analytical work.
2. Promote better understanding of monetary and banking policy in African countries.	2. To undertake country-focused research studies and surveys on a regular basis in order to promote and encourage monetary and financial stability, sustained growth and co-operation among member states.
3. Provide individual African countries with a source of independent and impartial advice	3. To participate and assist in the economic reforms of member states when called upon. To advise in

6. Enhance the professional standard of the personnel of African central banks by organizing training courses and seminars	6. To provide the analytical back-up facilities at all times necessary for member States to hold meetings aimed at developing Africa's common positions in international negotiations on monetary and financial issues.
7. Provide secretariat functions for the Association.	7. To explore channels for enhancing resource availability and on-lending AfMF members. This function has two complementary aspects: the mobilization of resources and ability to provide guarantees and/or collateral to member States wishing to borrow from third parties. Resources could be lent and guarantees provided for short, medium and long-term positions.
8. Discharge any other functions that the Association may entrust to it.	8. To act as a depository and manager of any extraordinary funds entrusted to it by the member States, non-member States, or any international entities in and outside Africa provided that such deposits and management are consistent with the constitution of the AfMF.
	9. To perform such other functions as may from time to time be assigned.

on monetary matters.	the drawing up of short, medium and long term programmes to ameliorate balance of payments disequilibria in a manner consistent with promoting monetary and financial stability in the member states.
4. Ensure by means of publications the dissemination to members of the Association of monetary and banking information of international and regional interest.	4. To provide members with up-to-date information on capital markets and available resources of credit for balance of payment financing including bilateral and multilateral sources. Provide technical assistance in the analysis of capital markets and in drawing for needful member states.
5. Undertake basic research in the monetary and banking fields.	5. To provide high-level training for member states in managerial, analytical, and policy-making capabilities in the areas of commercial policy, fiscal policy and monetary policy as may be determined by member states. In addition, to organize international symposia of experts in the African economy.

ORGANIZATIONAL STRUCTURE OF THE ACMS BEING TRANSFORMED INTO A NUCLEUS OF THE AFRICAN MONETARY FUND



103. All the functions of the African Centre for Monetary Studies can find counterpart expressions in seven of the nine functions of the proposed African Monetary Fund. Only Functions (7) and (8) of the AfMF connected with financing and management of funds for member countries, are not meant to be performed by the Centre.

104. Despite the close similarity between the functions of the Centre and those proposed for an AfMF, the Centre's functions are currently performed on a very small scale. The Centre can only be efficient as an AfMF only if it is strengthened very much beyond its current situation as explained elsewhere in this section.

C. Strategies and operational mechanisms

105. At its twenty-third meeting, the Governing Council of the African Centre for Monetary Studies discussed the strategies required to achieve the objectves of the Centre. Following an exchange of views, Governors agreed, among other decisions, as follows:

1. In performing its functions, the Centre must exercise prudence in the management of its resources including the adoption of cost-reducing measures and the appropriate placement of its funds.

2. Where a study would involve heavy financial costs that could not be supported by its budget, Governors could permit the Centre to seek additional funding from other institutions. However, such requests for extra funds would be examined and approved by Governors.

3. The Centre's research and training programmes must identify current African economic problems and policy issues and respond promptly.

4. The Centre can continue with pure research. However, the Centre's research must not duplicate the general and theoretical research undertaken at various African universities and research institutes. Rather, the Centre should study policy-related and current issues. Even so, the Centre is not required to undertake all research from scratch, it could collect and disseminate research findings of member central banks and other research economists.

5. In addition to pure research, the Centre should provide advisory services to Governors on topical issues. Such services should include position papers, and recommendations as well as forecasts of major trends in economic situations in both developed and developing countries. This would strengthen the ability of Governors in policy formulation and discussions in various fora.

6. The Centre should taken an inventory of training opportunities in member central banks in order to establish gaps that need to be filled and to avoid duplication. The Centre should also expand the possibilities of placing staff of member central banks in training courses and on-the-job training opportunities available at other member central banks so as to multiply the opportunities for training. Governors also agreed that the Centre's seminars should concentrate on topical issues and continue to draw also on guest lecturers from member central banks in order to reduce costs.

106., The above views expressed by Governors suggest that while the Centre was established with a view to providing significant contributions to policy formulation

in African countries, the continent-wide austerity, which has also affected the budget of Centre, has necessitated a narrowing down of the scale at which the Centre can perform its functions. To ameliorate the Centre's budgetary difficulties, Governors further agreed on a form of user-charges which required additional costs related to any technical assistance missions to countries to be borne by the member countries themselves. Furthermore, Governors considered ways of drawing on some external financial sources to support the Centre's research and training capacities.

107. These budgetary difficulties of the Centre appear to suggest also that it would be prudent for any resources that African governments would wish to commit for the establishment of an African Monetary Fund to be used to strengthen the African Centre for Monetary Studies. They also suggest that the operational mechanisms of the proposed African Monetary Fund should be established in phases according both to the priorities that might be attached to the various proposed functions and the possibilities of making the required financial contributions. Such a phased approach to the establishment of the AfMF has been suggested in chapter 2 above.

d. Organizational Structures

STRUCTURE OF THE ACMS	STRUCTURE OF THE AFMF
Assembly of Governors of the AACB (with subregional Committees)	Board of Governors (and consultative Committees)
Governing Council	Board of Executive Directors
Director General	Managing Director
The Secretariat:	The Secretariat
a) Research	a) Policy, Research and Training Department
b) Training Department	b) Technical Cooperation Department
c) Budget and Finance Department	c) General Resources Department
d) Administration Unit	d) Administration Department
	e) Legal Office

The organs of the Centre have also their counterparts in those proposed for an African Monetary Fund but the similarity here is not complete.

108. Whereas the Assembly of Governors of the Centre is made up of the Governors of the Association of African Central Banks, the Board of Governors of the AFMF may be composed or Ministries of Finance and Central Bank Governors.

109. The Assembly of Governors of the AACB and the subregional Committees may become consultative Committees in the structure of the AfMF. The Board of Executive Directors of the AfMF may be nonresident as in the case of the Governing Council of the Centre, and the Executive Directors and their Alternates may also be Central Bank Governors. However, the constituencies for election and the voting power may differ. Under the statutes of the Centre, two members from each of four subregions are elected by subregional committees. In addition, the member in whose country the Centre is established is represented on the Governing Council but without the right to vote. The constituencies and voting structure of the AfMF may, however, copy those of the African Development Bank. Also, whereas the Chairman of the Centre's Governing Council is elected from among the Governors, the Chairman of the Board of Executive Directors will be the Managing Director of the AfMF.

110. The Director General of the Centre is appointed by the Assembly of Governors upon the recommendation of the Governing Council. However, the Managing Director of the AfMF may be appointed directly by the Board of Governors. The Managing Director would be Chairman of the Board of Executive Directors, as explained above, and Chief Executive of the AfMF.

111. The Secretariat of the Fund would consist of four departments compared to the Centre's three departments.

However, the current core activities of the Centre may collapse into those of one department of the AfMF i.e. the Policy, Research and Training Department. The Centre now hardly undertakes technical cooperation activities except jointly with other African institutions. Even so, current budgetary difficulties of the Centre now constrains the participation of the Centre in joint studies and discussions with other African organizations. Direct technical cooperation with member countries has been included as part of the Centre's research strategy but none has yet been undertaken due to lack of funds. So far the Centre's input in member countries' policy formulation is only directly derived from the research output and publications as well as training programmes organized by the Centre.

e. Conclusions and Recommendations

112. The comparisons so far indicate that the Centre could be transformed to become the nucleus of the proposed African Monetary Fund. Such a transformation is relevant and advisable for two reasons. First, in view of the similarity of the objectives, functions and desired strategies of the Centre and those of the proposed African Monetary Fund, the creation of the latter would mostly duplicate the former in all respects except those functions related to financial operations.

113. Second, it would be more useful for African governments to take advantage of the existence of the Centre and build on its experience and contacts rather than create a new

institution that needs to start afresh. Over the years, African countries have sacrificed scarce resources to build the African Centre for Monetary Studies. The experience gained so far by the staff constitutes useful human resource investment that would enable the AfMF to take off quickly. A quick take-off by an African MOnetary Fund in the areas of research and training in policy formulation is essential given the critical economic situation in most African countries and the fact that very few of them have the required infrastructure for policy analysis.

114. Once the new centre has developed the capacity to produce defensible adjustment programmes, initially a small Fund (whose subscriptions would come from Central Banks) could be created for the purpose of financing balance of payments. This Fund, in the absence of banking functions at the ACMS, could be held by one of the member central banks. The former would prepare, together with a borrowing country, an economic adjustment programme which is then presented to a Board which will be created for the purpose of managing the Fund. This Board, composed of Central Bank Governors, would consider and approve the adjustment credit applications and then instruct the Central Bank which holds the Fund to disburse the funds to the borrowing country. In order to give authority to the Board of Directors of the Fund, a Monetary Council composed of Ministers responsible for Finance would need to be created. The council would be the highest governing body.

115. Since a portion of the Fund would be invested in liquid assets and the other is employed in balance of payments credits, the resulting income would be much greater than the expenditure involved. This is because the costs of the activities of policy analysis and adjustment programmes would initially be borne by the ACMS from its normal budget. And, since the Board of the Fund would, be composed of Central Bank Governors who would therefore, manage the Fund on a part-time basis, the costs involved would be restricted to travelling and per diem expenses. In addition to these minimal costs, the Fund would pay the costs of transactions carried out by the Central Bank which holds the Fund. This Central Bank may or may not wish to charge the Fund for the use of its staff, furniture, equipment etc. In case these costs would need to be paid, a formula can be found for determining the amount to be paid. But, in the spirit of solidarity the Fund holding Central Bank may waive these costs. As the net income of the Fund grows, all the above costs could be absorbed by the institution.

116. The benefits of this option are many. First, though the initial subscription will be small, the Fund will have been established, showing concrete evidence of commitment by African countries toward regional monetary cooperation and integration. Second, and most important, the administrative costs would not constitute a significant burden on member countries during the initial years when the institution is being tested. Third, Africa would have

an arrangement, at least cost, which could produce alternative adjustment policies to those advocated by the IMF, for instance. Fourth, a source of additional finance for adjustment would have been created.

117. The only disadvantage of this option is that the Fund would have no legal status in international law and therefore would not be able to borrow externally. All it could do is to obtain grants from bilateral donors in order to supplement subscriptions by its members. However, there is no reason why, once in a sound financial standing, the Fund could not be given legal status.

118. Given the financial crisis Africa is facing, it is clear that the benefits of this option far exceed the costs. Therefore, it is recommended that this option be given serious consideration.